

APPENDIX

Act of March 27, 1934, c. 95, 48 Stat. 503:

SEC. 3. The Secretary of the Navy is hereby directed to submit annually to the Bureau of the Budget estimates for the construction of the foregoing vessels and aircraft; and there is hereby authorized to be appropriated such sums as may be necessary to carry into effect the provisions of this Act: *Provided*, That no contract shall be made by the Secretary of the Navy for the construction and/or manufacture of any complete naval vessel or aircraft, or any portion thereof, herein, heretofore, or hereafter authorized unless the contractor agrees—

(a) To make a report, as hereinafter described, under oath, to the Secretary of the Navy upon the completion of the contract.

(b) To pay into the Treasury profit, as hereinafter provided shall be determined by the Treasury Department, in excess of 10 per centum of the total contract price, such amount to become the property of the United States: *Provided*, That if such amount is not voluntarily paid the Secretary of the Treasury may collect the same under the usual methods employed under the internal revenue laws to collect Federal income taxes.

(c) To make no subdivisions of any contract or subcontract for the same article or articles for the purpose of evading the provisions of this Act, but any subdivision of any contract or subcontract involving an

amount in excess of \$10,000 shall be subject to the conditions herein prescribed.

(d) That the manufacturing spaces and books of its own plant, affiliates, and subdivisions shall at all times be subject to inspection and audit by any person designated by the Secretary of the Navy, the Secretary of the Treasury, and/or by a duly authorized committee of Congress.

(e) To make no subcontract unless the subcontractor agrees to the foregoing conditions.

The report shall be in form prescribed by the Secretary of the Navy and shall state the total contract price, the cost of performing the contract, the net income, and the per centum such net income bears to the contract price. A copy of such report shall be transmitted to the Secretary of the Treasury for consideration in connection with the Federal income tax returns of the contractor for the taxable year or years concerned.

The method of ascertaining the amount of excess profit to be paid into the Treasury shall be determined by the Secretary of the Treasury in agreement with the Secretary of the Navy and made available to the public. The method initially fixed upon shall be so determined on or before June 30, 1934: *Provided*, That in any case where an excess profit may be found to be owing to the United States in consequence hereof, the Secretary of the Treasury shall allow credit for any Federal income taxes paid or remaining to be paid upon the amount of such excess profit.

The contract or subcontracts referred to herein are limited to those where the award exceeds \$10,000.

(34 U. S. C. Sec. 496.)

Act of June 25, 1936, c. 812, 49 Stat 1926:

* * * section 3 (b) of an Act entitled "An Act to establish the composition of the United States Navy with respect to the categories of vessels limited by the treaties signed at Washington, February 6, 1922, and at London, April 22, 1930, at the limits prescribed by those treaties; to authorize the construction of certain naval vessels; and for other purposes", approved March 27, 1934 (48 Stat. 505), is hereby amended * * * so that as amended said section 3 (b) will read as follows:

"SEC. 3. (b) To pay into the Treasury profit, as hereinafter provided shall be determined by the Treasury Department, in excess of 10 per centum of the total contract prices, of such contracts within the scope of this section as are completed by the particular contracting party within the income taxable year, such amount to become the property of the United States, but the surety under such contracts shall not be liable for the payment of such excess profit: *Provided*, That if there is a net loss on all such contracts or subcontracts completed by the particular contractor or subcontractor within any income taxable year, such net loss shall be allowed as a credit in determining the excess profit, if any, for the next succeeding income taxable year: *Provided further*, That if such amount is not voluntarily paid the Secretary of the Treasury shall collect the same under the usual methods employed under the internal-revenue laws to collect Federal income taxes: *Provided further*, That all provisions of law (including penalties) applicable with respect to the taxes imposed by Title I of the Revenue Act of 1934, and not inconsistent

with this section, shall be applicable with respect to the assessment, collection, or payment of excess profits to the Treasury as provided by this section, and to refunds by the Treasury of overpayments of excess profits into the Treasury: *And provided further*, That this section shall not apply to contracts or subcontracts for scientific equipment used for communication, target detection, navigation, and fire control as may be so designated by the Secretary of the Navy, and the Secretary of the Navy shall report annually to the Congress the names of such contractors and subcontractors affected by this provision, together with the applicable contracts and the amounts thereof: *And provided further*, That the income-taxable years shall be such taxable years beginning after December 31, 1935, except that the above provisos relating to the assessment, collection, payment, or refunding of excess profit to or by the Treasury shall be retroactive to March 27, 1934." (34 U. S. C. Sec. 496.)

T. D. 4434, XIII-1 Cum. Bull. 540, 541, 542 (1934):

The method of ascertaining the amount of excess profit to be paid to the United States in respect of contracts entered into under the Vinson Act shall be as follows:

The excess profit shall be determined on each contract separately upon the completion or other termination of the contract. The amount of such excess profit shall be the amount of the profit on the contract in excess of 10 percent of the total contract price. The amount of the profit on the contract shall be the difference between the total contract price and the cost of per-

forming the contract. The cost of performing the contract shall be the direct costs, such as material and labor, incurred by the contractor in performing the contract, plus a reasonable proportion of any indirect costs (including overhead or general expenses) appertaining to the contract which are not usually directly allocated to the cost of performing the contract. No general rule may be stated for ascertaining the reasonable proportion of the indirect costs to be allocated to the cost of performing a contract which would be applicable to all cases. The proper proportion of the indirect costs to be applied to the cost of performing a particular contract depends upon all the facts and circumstances relating to the performance of the particular contract. The contractor shall include as a part of the report required to be made to the Secretary of the Navy upon the completion or other termination of the contract, a statement explaining the manner in which such indirect costs were determined and allocated to the cost of performing the contract.

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T. D. 4723, 1937-1 Cum. Bull. 519, 520, 521, 523:

ARTICLE 1. *Definitions*.—As used in these regulations the term—

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(g) "Contracting party" means a contractor or subcontractor as the case may be.

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ART. 2. *Contracts and subcontracts under which excess profit liability may be incurred*.—Except as otherwise provided

with respect to contracts or subcontracts for certain scientific equipment (see article 3 of these regulations), every contract awarded for an amount exceeding \$10,000 and entered into after the enactment of the Act of March 27, 1934, for the construction or manufacture of any complete naval vessel or aircraft, or any portion thereof, is subject to the provisions of the Act relating to excess profit liability. Any subcontract made with respect to such a contract and involving an amount in excess of \$10,000 is also within the scope of the Act. If a contracting party places orders with another party, aggregating an amount in excess of \$10,000, for articles or materials which constitute a part of the cost of performing the contract or subcontract, the placing of such orders shall constitute a subcontract within the scope of the Act, unless it is clearly shown that each of the orders involving \$10,000 or less is a bona fide separate and distinct subcontract and not a subdivision made for the purpose of evading the provisions of the Act.

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ART. 8. *Cost of performing a contract or subcontract.*—(a) *General rule.*—The cost of performing a particular contract or subcontract shall be the sum of (1) the direct costs, including therein expenditures for materials, direct labor and direct expenses, incurred by the contracting party in performing the contract or subcontract; and (2) the proper proportion of any indirect costs (including therein a reasonable proportion of management expenses) incident to and necessary for the performance of the contract or subcontract.

(b) *Elements of cost.*—No definitions of the elements of cost may be stated which

are of invariable application to all contractors and subcontractors. In general, the elements of cost may be defined for purposes of the Act as follows:

(1) Manufacturing cost, which is the sum of factory cost (see paragraph (c) of this article) and other manufacturing cost (see paragraph (d) of this article);

(2) Cost of installation and construction (see paragraph (e) of this article); and

(3) General expenses, which are the sum of indirect engineering expenses, usually termed "engineering overhead" (see paragraph (f) of this article) and expenses of administration, usually termed "administrative overhead" (see paragraph (g) of this article).

(c) *Factory cost*.—Factory cost is the sum of the following:

(1) *Direct materials*.—Materials, such as those purchased for stock and subsequently issued for contract operations and those acquired under subcontracts, which become a component part of the finished product or which are used directly in fabricating, converting or processing such materials or parts.

(2) *Direct productive labor*.—* * *

(3) *Direct engineering labor*.—* * *

(4) *Miscellaneous direct charges*.—* * *

(5) *Indirect factory expenses*.—* * *

(A) *Labor*.—* * *

(B) *Material and supplies*.—* * *

(C) *Service expenses*.—* * *

(D) *Fixed charges*.—* * *

(E) *Miscellaneous indirect factory expenses*.—* * *

(d) *Other manufacturing cost*.—* * *

(e) *Cost of installation and construction.*—* * *

(f) *Indirect engineering expenses.*—* * *

(1) *Labor.*—* * *

(2) *Material.*—* * *

(3) *Miscellaneous expenses.*—* * *

(g) *Expenses of administration.*—* * *

(1) *Compensation for personal services of employees.*—* * *

(2) *Expenses.*—* * *

Allowances for interest on invested capital are not allowable as costs of performing a contract or subcontract.

Among the items which shall not be included as a part of the cost of performing a contract or subcontract or considered in determining such cost, are the following: Selling expenses, including compensation of employees engaged in selling, operation and maintenance of sales offices, commissions, advertising and demonstrations, depreciation of sales equipment, gratis service, entertainment expenses; dues and memberships other than of regular trade associations; donations; commercial traveling expenses and the like; losses on other contracts; losses from sales or exchanges of capital assets; extraordinary expenses due to strikes or lockouts; fines and penalties; amortization of unrealized appreciation of values of assets; expenses and depreciation of idle plant; increases in reserve accounts for contingencies, repairs, compensation insurance and guarantee work; Federal and State income and excess profits taxes and surtaxes; cash discount earned up to 1 percent of the amount of the purchase, except that all discounts on subcontracts subject to the Act will be considered; interest incurred or earned;

bond discount or finance charges; income from royalties; premiums for life insurance on the lives of officers; legal and accounting fees in connection with reorganizations, security issues, capital stock issues and the prosecution of claims against the United States (including income tax matters); taxes and expenses on issues and transfers of capital stock; losses on investments; bad debts; and expenses of collection and exchange.

In order that the cost of performing a contract or subcontract may be accounted for clearly, the amount of any excess profits repayable to the United States pursuant to the Act should not be charged to or included in such cost.

Excessive or unreasonable payments whether in cash, stock or other property ostensibly for salaries, bonuses or other compensation for personal services, may not be included in the cost of performing a contract or subcontract.

- (h) *Allocation of indirect costs.*—* * *
- (1) *Factory indirect expenses.*—* * *
- (2) *Engineering indirect expenses.*—
* * *
- (3) *Administrative expenses (or "overhead").*—* * *

